

THE HONORABLE MARSHA J. PECHMAN

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

IN RE WASHINGTON MUTUAL, INC.
SECURITIES, DERIVATIVE & ERISA
LITIGATION

No. 2:08-md-1919 MJP

Lead Case No. C08-387 MJP

IN RE WASHINGTON MUTUAL, INC.
SECURITIES LITIGATION

This Document Relates to:

ALL ACTIONS

**REPLY MEMORANDUM IN SUPPORT
OF OUTSIDE DIRECTOR
DEFENDANTS' MOTION TO DISMISS
THE AMENDED CONSOLIDATED
CLASS ACTION COMPLAINT**

[DD-06]

Note for Motion: August 25, 2009

ORAL ARGUMENT REQUESTED

REPLY MEMORANDUM IN SUPPORT OF OUTSIDE DIRECTOR
DEFENDANTS' MOTION TO DISMISS THE AMENDED CONSOLIDATED
CLASS ACTION COMPLAINT [DD-06] (No. 2:08-md-1919 MJP)

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1 The Outside Director Defendants respectfully submit this reply memorandum in further
2 support of their Motion to Dismiss the Amended Consolidated Class Action Complaint
3 ("Motion").
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5 6 7 I. INTRODUCTION

8
9 Lead Plaintiff's Opposition to the Outside Director Defendants' Motion to Dismiss the
10 Amended Consolidated Class Action Complaint ("Opposition" or "Opp.") relies on the false
11 premise that the Court has already rejected the arguments raised by the Outside Director
12 Defendants in their Motion. Rather than attempt to respond to the Outside Director Defendants'
13 substantive arguments, the Opposition primarily argues that the Court should not even consider
14 the arguments raised in the Motion. Plaintiffs' Opposition is unpersuasive for several reasons.
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17 First, the Court specifically stated in its order on the motions to dismiss the Prior
18 Complaint that the Outside Director Defendants' motion to dismiss the control person claim
19 under the Securities Exchange Act of 1934 ("Exchange Act") would be considered after plaintiffs
20 filed the Amended Consolidated Class Action Complaint ("Amended Complaint" or "Am.
21 Compl."). The facts alleged in support of this claim offer nothing more than boilerplate
22 descriptions of the roles of directors and the functions of board committees. The allegations fail
23 to provide any specific facts connecting the Outside Director Defendants to the alleged
24 misconduct at Washington Mutual, Inc. ("WaMu"), to the public disclosures containing the
25 alleged misrepresentations and omissions, or describing their involvement in day-to-day
26 activities at WaMu. The types of general descriptions of board responsibilities and board
27 committee functions alleged in the Amended Complaint apply to outside directors of any public
28 company. Permitting a control person claim to proceed based on facts which may be alleged
29 against any director of any public company effectively removes any substantive pleading
30 requirements for control person claims against outside directors.
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33 Second, the Amended Complaint's alleged facts in support of the control person claim
34 under Section 15 of the Securities Act of 1933 ("Securities Act") fare no better, since the
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1 pleading requirements for a control person claim under both statutes is the same.

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3 Notwithstanding plaintiffs' protestations to the contrary, the Court's ruling on the Section 15
4 claim in the Prior Complaint does not present an impediment to the Motion because that ruling
5 relied on alleged facts which did not appear in the Securities Act section of the Prior Complaint.
6

7 But even if alleged facts regarding control from the Exchange Act section of the Amended
8 Complaint are applied to the Securities Act control person claim, that claim should be dismissed.
9
10 The conclusory, general, boilerplate facts alleged regarding the role of the Outside Director
11 Defendants do not provide an adequate basis to sustain the control person claims under either the
12 Exchange Act or the Securities Act.
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15 Third, to determine which pleading standard to apply to the Securities Act claim against
16 the Outside Director Defendants, Ninth Circuit law provides that the Court is to carefully
17 examine the allegations in the Amended Complaint and assess whether the Securities Act
18 allegations against the Outside Director Defendants are based on a unified course of allegedly
19 fraudulent conduct pled throughout the Amended Complaint. The Court should not simply rely
20 on plaintiffs' self-serving assertions in the Amended Complaint or the Opposition denying that
21 the Securities Act claim against the Outside Director Defendants relies on fraud. Rather, the
22 Court should independently scrutinize the allegations of the Amended Complaint as a whole. In
23 conducting this review, the focus is not on the causes of action asserted against each defendant.
24 Rather, the test is whether, taken as a whole, the Amended Complaint alleges a unified fraud
25 theory thereby requiring application of Federal Rule of Civil Procedure ("Rule") 9(b) to all
26 claims. Where, as here, the Securities Act claim against the Outside Director Defendants relies
27 on the same alleged facts which support the fraud thesis of the Exchange Act claims, Ninth
28 Circuit precedent requires that the Securities Act claim satisfy Rule 9(b), even though there are
29 no primary Exchange Act causes of action against the Outside Director Defendants.
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II. THE EXCHANGE ACT CONTROL PERSON CLAIM AGAINST THE OUTSIDE DIRECTOR DEFENDANTS SHOULD BE DISMISSED

Despite plaintiffs' assertion that the Court previously "addressed and rejected every one of the arguments presented in the Outside Directors' current motion to dismiss," Opp. at 1, the Court declined to rule on the Outside Director Defendants' motion to dismiss the Section 20(a) claim in the Prior Complaint. *In re Wash. Mut., Inc. Sec., Derivative & ERISA Litig.*, No. 2:08-MD-1919 MJP, C08-387 MJP, 2009 WL 1393679, at *13 (W.D. Wash. May 15, 2009) ("The Court will consider the Section 20(a) claims for control person liability against the Outside Director Defendants after Plaintiffs file an amended complaint."). Apparently relying on their own false premise that the Court had already sustained the Exchange Act control person claim against the Outside Director Defendants, plaintiffs' Amended Complaint alleges no additional facts to support their control person claim. The Amended Complaint relies on the same deficient, conclusory allegations of standard duties of typical board committees and nothing more.

In order to adequately plead a control person claim under Section 20(a), plaintiffs must allege facts demonstrating that the Outside Director Defendants were active in the day-to-day affairs of WaMu or that they exercised specific control over the preparation and release of the public disclosures containing the alleged misstatements and omissions. *In re Immune Response Sec. Litig.*, 375 F. Supp. 2d 983, 1031 (S.D. Cal. 2005). In their Motion, the Outside Director Defendants cited numerous cases in which courts have concluded that boilerplate allegations of a director's role on the board, his or her membership on certain board committees or allegations regarding the standard functions of board committees, such as those in the Amended Complaint, are insufficient to plead a control person claim. *See* Motion at 5-6. With regard to the subject of control, the Amended Complaint alleges nothing more than that:

- The Outside Director Defendants were directors of WaMu, Am. Complt. ¶¶ 29-39;

- 1 • The Outside Director Defendants signed certain public filings, Am. Complt.
2 ¶ 660;
- 3 • The Outside Director Defendants served on board committees, including the
4 finance and audit committees, Am. Complt. ¶¶ 661-671; and
- 5 • The finance and audit committees had functions and responsibilities typical of
6 finance and audit committees of any public company, Am. Complt. ¶¶ 661-664;
7 666-669.

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Such allegations are not particularized to the Outside Director Defendants' involvement in the specific misconduct alleged nor do they plausibly support the conclusion that the Outside Director Defendants were involved in day-to-day activities at WaMu. Instead, the meager alleged facts constitute general descriptions of director and board committee responsibilities applicable to board members and board committees of virtually all public companies. Motion at 8-9. Courts have repeatedly rejected such allegations as insufficient, and so should this Court. *See, e.g., Wool v. Tandem Computers Inc.*, 818 F.2d 1433 (9th Cir. 1987); *Westland Police & Fire Ret. Sys. v. Sonic Solutions*, No. C 07-05111 CW, 2009 WL 942182, at *11 (N.D. Cal. Apr. 6, 2009); *Al-Thani v. Wells Fargo & Co.*, No. C 08-1745 CW, 2009 WL 55442, at *9 (N.D. Cal. Jan. 7, 2009).

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Instead of responding to the argument that the allegations in the Amended Complaint as to the finance and audit committees provide nothing more than an articulation of the functions generally performed by such board committees, plaintiffs argue that the Court should not take judicial notice of certain documents that were publicly filed with the United States Securities and Exchange Commission ("SEC") and submitted in support of the Motion. Opp. at 2-3. This argument is unpersuasive for several reasons. First, courts may take judicial notice of documents filed with the SEC, and there is no general rule that only documents submitted to the SEC by a party in the lawsuit are appropriate for judicial notice. *See Metzler Inv. GMBH v. Corinthian Colls., Inc.*, 540 F.3d 1049, 1064 n.7 (9th Cir. 2008). Second, the Outside Director Defendants

1 submitted these documents not for the truth of their contents—i.e., to show that these other
 2 companies' board committees actually performed the roles described in the filings—but instead
 3 to show that plaintiffs' allegations amount to a general description of typical functions of
 4 standard board committees of public companies. *See, e.g., Lovelace v. Software Spectrum, Inc.*,
 5 78 F.3d 1015, 1018 (5th Cir. 1996) (on a motion to dismiss, court may consider contents of
 6 relevant public disclosure documents that are required to be filed with the SEC and are in fact
 7 filed with the SEC, provided that documents are considered only for purposes of determining
 8 what statements those documents contain).

9
 10 The Opposition also quarrels with the Outside Director Defendants' discussion of the
 11 Court's decision in *Fouad v. Isilon Systems, Inc.*, No. C07-1764 MJP, 2008 WL 5412397 (W.D.
 12 Wash. Dec. 29, 2008). Plaintiffs incorrectly argue that the Outside Director Defendants have
 13 already attempted to distinguish that case. Opp. at 6. However, none of the Outside Director
 14 Defendants' prior briefs attempted to distinguish *Fouad*. The Court inquired about similarities
 15 between *Fouad* and the instant case during oral argument on the motions to dismiss the Prior
 16 Complaint, and the Motion addresses the question raised by the Court.

17
 18 Unlike this case, the complaint in *Fouad* contained specific allegations concerning the
 19 audit committee's investigation of the underlying fraud. Also unlike this case, in *Fouad*, all of
 20 the directors who were charged as control persons were also executives of the company,
 21 chairpersons of their respective board committees, or representatives of various venture capital
 22 firms that were the company's major shareholders. Finally, the case law on which the Court
 23 relied in sustaining the control person claim in *Fouad*, including *In re Metawave*
 24 *Communications Corp. Securities Litigation*, 298 F. Supp. 2d 1056 (W.D. Wash. 2003), and
 25 *Arthur Children's Trust v. Keim*, 994 F.2d 1390 (9th Cir. 1993), is readily distinguishable from
 26 the facts presented here. Motion at 11. Plaintiffs' Opposition ignores these arguments, relying
 27 again on the false assertion that the Court has already rejected them. Opp. at 6.

1 The alleged facts purporting to establish control in the Amended Complaint are entirely
 2 illusory and provide no details regarding any role played by the Outside Director Defendants in
 3 any of the alleged misconduct or the alleged misrepresentations and omissions on which the
 4 Amended Complaint is based. As such, these allegations fail to show that the Outside Director
 5 Defendants "exercised specific control over the preparation and release of the alleged
 6 statements," *In re Immune Response*, 375 F. Supp. 2d at 1031, "how [the directors] controlled
 7 specific Section 10(b) defendants," *In re McKesson HBOC, Inc. Sec. Litig.*, 126 F. Supp. 2d
 8 1248, 1277 (N.D. Cal. 2000), or were otherwise specifically involved in the day-to-day affairs of
 9 WaMu, *Batwin v. Occam Networks, Inc.*, No. CV 07-2750 CAS (SHx), 2008 WL 2676364, at
 10 *25 (C.D. Cal. July 1, 2008). Because the Amended Complaint contains no alleged facts other
 11 than sparse recitations of standard board and committee functions, the Exchange Act control
 12 person claim against the Outside Director Defendants should be dismissed with prejudice.

23 **III. THE SECURITIES ACT CONTROL PERSON CLAIM AGAINST THE** 24 **OUTSIDE DIRECTOR DEFENDANTS SHOULD BE DISMISSED**

25 Plaintiffs' control person claim under Section 15 of the Securities Act is subject to the
 26 same pleading requirements as the Section 20(a) claim under the Exchange Act and fails for the
 27 same reasons discussed in the previous section. Plaintiffs' reliance on the Court's ruling with
 28 respect to the Section 15 claim in the Prior Complaint is misplaced. First, that ruling was
 29 premised on allegations taken from the Exchange Act portion of the Prior Complaint, which
 30 plaintiffs had not incorporated into their Securities Act claims. Second, even if allegations from
 31 the Exchange Act section of the Amended Complaint may be considered in support of the
 32 Securities Act claim, these general, boilerplate factual assertions fail to satisfy the pleading
 33 requirements for control person liability. The Outside Director Defendants cannot be held liable
 34 as control persons for the purported Securities Act violations of others based on nothing more
 35 than their signatures on the Offering Documents and their service on board committees. To hold
 36 otherwise would create per se control person liability against any director with respect to any

1 securities offering issued while he or she served as a director. The Securities Act control person
 2 claim against the Outside Director Defendants should be dismissed with prejudice.
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 5 **IV. THE SECTION 11 CLAIM AGAINST THE OUTSIDE DIRECTOR**
 6 **DEFENDANTS IS BASED ON THE AMENDED COMPLAINT'S UNIFIED COURSE OF**
 7 **ALLEGEDLY FRAUDULENT CONDUCT AND SHOULD BE DISMISSED FOR**
 8 **FAILURE TO SATISFY RULE 9(B)**
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10 The Amended Complaint alleges that the Officer Defendants, acting collectively, caused
 11 WaMu to engage in four types of supposed improper activity during the Class Period:
 12

13 (1) deliberate efforts to decrease the efficacy of WaMu's risk management policies; (2) deliberate
 14 corruption of WaMu's appraisal policies; (3) deliberate abandonment of appropriate underwriting
 15 standards for WaMu loans; and (4) intentional misrepresentations of WaMu's financial results.
 16

17 Am. Compl. ¶ 1. The Officer Defendants who allegedly caused WaMu to engage in these
 18 improper activities include Kerry K. Killinger and Thomas Casey. Am. Compl. ¶ 2. For their
 19 Exchange Act claims, plaintiffs allege that the Officer Defendants made false and misleading
 20 statements and omissions concerning these four categories of improper activity in several of
 21 WaMu's public disclosures, and that these alleged misstatements and omissions supposedly
 22 caused artificial inflation of the price of WaMu's securities during the Class Period. Am.
 23

24 Compl. ¶ 8. The public disclosures at issue include the Offering Documents, and in support of
 25 the Securities Act claims, plaintiffs allege that the Offering Documents contained material
 26 misstatements and omissions. Am. Compl. ¶ 678. The alleged misrepresentations and
 27 omissions in the Offering Documents concern the very same four categories of purported
 28 improper activity at issue in the Exchange Act claims. Am. Compl. ¶¶ 719-752.
 29

30 With respect to the Prior Complaint, the Court acknowledged that the Section 11 claim
 31 against Officer Defendants Killinger and Casey "allege[s] misrepresentations regarding much of
 32 the same conduct . . . forming the basis of Plaintiffs' fraud claims against them under the
 33 Exchange Act." *In re Wash. Mut., Inc. Sec., Derivative & ERISA Litig.*, 2009 WL 1393679, at
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35 *13. In the Amended Complaint, as in the Prior Complaint, the alleged core misconduct that
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1 forms the basis for the alleged misrepresentations and omissions in violation of the Exchange
 2 Act against Officer Defendants Killinger and Casey is the same as the alleged misconduct
 3 underlying the Securities Act claims. A fair reading of the Amended Complaint demonstrates
 4 that the alleged Securities Act violation by the Outside Director Defendants is based on the same
 5 core, allegedly fraudulent conduct which forms the basis of the Exchange Act and Securities Act
 6 claims against Officer Defendants Killinger and Casey, who are named in both the Exchange Act
 7 and Securities Act claims.
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10 The sounds-in-fraud doctrine is well established in the Ninth Circuit. *See Rubke v.*
 11 *Capitol Bancorp Ltd.*, 551 F.3d 1156 (9th Cir. 2009); *In re Daou Sys., Inc.*, 411 F.3d 1006 (9th
 12 Cir. 2005); *Vess v. Ciba-Geigy Corp. USA*, 317 F.3d 1097 (9th Cir. 2003); *In re Stac Elecs. Sec.*
 13 *Litig.*, 89 F.3d 1399 (9th Cir. 1996). The application of the sounds-in-fraud doctrine does not
 14 depend on the elements of the specific causes of action asserted against particular defendants but
 15 focuses instead on the underlying facts and the nature of the conduct alleged in the complaint,
 16 regardless of plaintiff's characterization of those facts. *See Vess*, 317 F.3d at 1103-04. Where, as
 17 here, a plaintiff alleges a unified course of fraudulent conduct throughout the complaint and
 18 relies entirely on that course of conduct to support Securities Act claims, those claims are
 19 grounded in fraud and must satisfy the particularity requirements of Rule 9(b). *Id.* The analysis
 20 is not dependent on whether the complaint asserts fraud-based or non-fraud-based causes of
 21 action against certain defendants and not others. *See Batwin*, 2008 WL 2676364, at *19. Nor is
 22 it based on whether plaintiffs disclaim reliance on fraud as to any particular claim or any
 23 particular parties. *In re Stac*, 89 F.3d at 1405 n.2; *Vess*, 317 F.3d at 1108.
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 25

26 Relying on excerpts from *In re Countrywide Financial Securities Litigation*, 588 F. Supp.
 27 2d 1132, 1163 (C.D. Cal. 2008), plaintiffs argue that because the Amended Complaint does not
 28 explicitly allege that the Outside Director Defendants acted fraudulently and because plaintiffs
 29 deny that they are alleging fraud against the Outside Director Defendants, none of the Amended
 30 Complaint's claims against the Outside Director Defendants sound in fraud. *Opp.* at 8-9. But
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1 this argument is logically inconsistent with and renders meaningless the sounds-in-fraud doctrine
2 as it has developed in the Ninth Circuit. There is no question that if the Amended Complaint
3 explicitly alleged fraud-based causes of action against the Outside Director Defendants, the
4 particularity requirements of Rule 9(b) would apply. In such circumstances, the sounds-in-fraud
5 analysis is unnecessary. However, the sounds-in-fraud doctrine exists precisely for
6 circumstances like those presented here in which plaintiffs assert that their Securities Act claim
7 does not rely on fraud. The sounds-in-fraud doctrine requires the Court to independently and
8 carefully consider the complaint as a whole to determine whether plaintiff alleges a unified
9 course of fraudulent conduct that underlies all of its assertions of misrepresentations or
10 omissions, *even if* the complaint does not allege specific fraud-based causes of action against
11 certain defendants. *In re Daou Sys.*, 411 F.3d at 1027.
12

13 Plaintiffs' reliance on the *Countrywide* decision is misplaced. The court in *Countrywide*
14 deferred entirely to plaintiffs' assertion regarding which defendants had engaged in fraud, and the
15 court did not conduct an independent analysis of the complaint as a whole—as required by the
16 Ninth Circuit—to determine whether the conduct underlying other claims against the defendants
17 was based on a unified course of fraudulent conduct. *See Vess*, 317 F.3d at 1104. The approach
18 taken by the *Countrywide* court is inconsistent with the analysis required by the Ninth Circuit for
19 purposes of applying the sounds-in-fraud doctrine. "To ascertain whether a complaint 'sounds in
20 fraud,' we must normally determine, after a close examination of the language and structure of
21 the complaint, whether the complaint 'allege[s] a unified course of fraudulent conduct' and
22 'rel[ies] entirely on that course of conduct as the basis of a claim.'" *Rubke*, 551 F.3d at
23 1161(quoted *Vess*, 317 F.3d at 1103-04) . In *Rubke* the Ninth Circuit noted that where, as here,
24 a complaint employs the exact same factual allegations to allege a Section 11 claim as it uses to
25 allege fraudulent conduct in connection with an Exchange Act claim, the court "can assume that
26 it sounds in fraud." *Id.* (citing *Daou*, 411 F.3d at 1028).
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1 Contrary to plaintiffs' assertion, Opp. at 9, the Motion provides a number of specific
2 examples demonstrating that the factual allegations underlying the admittedly fraud-based
3 Exchange Act claims against Officer Defendants Killinger and Casey are the same as those
4 which underlie the Section 11 claim against the Outside Director Defendants. Motion at 17-19.
5 Instead of addressing these points, the Opposition cites to the Amended Complaint's conclusory
6 allegation asserting that none of the Outside Director Defendants "made a reasonable
7 investigation or possessed reasonable grounds for the belief that the statements contained in the
8 Offering Documents were accurate and complete in all material respects" as evidence that the
9 Amended Complaint in fact pleads a negligence theory as to the Outside Director Defendants.
10 Opp. at 7-8.

11 For several reasons, this negligence allegation does not plausibly present a viable
12 negligence theory against the Outside Director Defendants and does not alter the conclusion that
13 the core facts and alleged underlying conduct are the same for both the Exchange Act and
14 Securities Act claims in the Amended Complaint. First, the conclusory allegation of negligence
15 does not contain specific facts as to the Outside Director Defendants, but offers, in essence, a
16 legal conclusion concerning plaintiffs' view regarding due diligence requirements for public
17 offerings. It is boilerplate language concerning the purported role of directors, officers,
18 underwriters and accountants in due diligence. Such an allegation is no more substantive than
19 plaintiffs' efforts to disclaim reliance on fraud in connection with the Securities Act claims and
20 therefore should be disregarded by the Court in considering the Motion. *See In re Stratosphere*
21 *Corp. Sec. Litig.*, 1 F. Supp. 2d 1096, 1104 (D. Nev. 1998) (disregarding boilerplate assertions
22 that claims are based in negligence and not fraud, and applying requirements of Rule 9(b) to
23 Securities Act claims). Second, this conclusory negligence allegation is the only negligence
24 allegation against the Outside Director Defendants in the entire 877-paragraph Amended
25 Complaint and utterly lacks specific factual support. *See Bell Atl. Corp. v. Twombly*, 550 U.S.
26 544, 555 (2007) (noting that factual allegations must be sufficient to raise a right to relief beyond
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1 the speculative level to survive a challenge on a motion to dismiss). When compared to the
 2 allegations of fraud that permeate the Amended Complaint, plaintiffs' assertion that the alleged
 3 misrepresentations and omissions in the Offering Documents were the result of mere negligence
 4 is implausible.
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7
 8 Because the Section 11 claim against the Outside Director Defendants is based on the
 9 same core factual allegations and alleged course of conduct that plaintiffs concede is fraudulent
 10 as to Officer Defendants Killinger and Casey, no matter where it appears in the Amended
 11 Complaint, the Amended Complaint's Section 11 claim against the Outside Director Defendants
 12 sounds in fraud and must satisfy Rule 9(b). If the Court requires the application of Rule 9(b) to
 13 the Securities Act claim against the Outside Director Defendants – as it should – then the claims
 14 cannot survive. Although, as plaintiffs assert, Opp. at 10, an allegation of scienter is not
 15 required, plaintiffs have nevertheless failed to connect each individual Outside Director
 16 Defendant to the alleged misconduct, which is required by Rule 9(b). *In re Stac*, 89 F.3d at
 17 1411. The Amended Complaint offers no facts, let alone detailed facts, connecting the Outside
 18 Director Defendants to the alleged misstatements and omissions in the Offering Documents.
 19 Therefore, when Rule 9(b) is appropriately applied to plaintiffs' Section 11 claim against the
 20 Outside Director Defendants, the claim fails to satisfy the substantive particularity requirements.
 21 Accordingly, the Section 11 claim against the Outside Director Defendants should be dismissed
 22 with prejudice.
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 24

25 V. CONCLUSION

26 For the foregoing reasons and the reasons set forth in the Motion, the Outside Director
 27 Defendants respectfully request that the Court dismiss all claims against them with prejudice.
 28 *See Zucco Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 1007 (9th Cir. 2009) (dismissal of a
 29 claim with prejudice appropriate where there is "a strong indication that the plaintiffs have no
 30 additional facts to plead.") (quotation marks and internal citations omitted).
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2 DATED: August 25, 2009
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CERTIFICATE OF SERVICE

I hereby certify that on August 25, 2009, I electronically filed the foregoing with the Clerk of the Court using the CM/ECF system, which will send notification of such filing to the email addresses indicated on the Court's Electronic Mail Notice List, and I hereby certify that I have mailed the foregoing document via United States first class mail, postage prepaid, to the non-CM/ECF participants indicated on the Court's Manual Notice List.

DATED at Seattle, Washington, this 25th day of August, 2009.

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